DEPARTMENT OF STATE REVENUE
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Income Tax
For Tax Years 2000-02

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ISSUE

I. Income Tax—Nexus.

Authority: *Wisconsin Department of Revenue v. William Wrigley, Jr.*, 505 U.S. 214 (1992); 15 U.S.C. 381 (Public Law 86-272); *Enterprise Leasing Company of Chicago v. Indiana Department of State Revenue*, 779 N.E.2d 1284 (Ind. Tax Ct. 2002); *Indiana Department of Revenue v. Kimberly-Clark Corporation*, 416 N.E.2d 1264 (Ind. 1981); IC § 6-2.1-2-2; IC § 6-3-2-2; IC § 6-3-8-5; 45 IAC 1.1-1-3; 45 IAC 3.1-1-38

Taxpayer protests that it does not have nexus with Indiana for income tax purposes.

STATEMENT OF FACTS

Taxpayer is in the pharmaceutical industry nationwide. There were two separate audit reports due to a merger between sister companies in 2001. The two entities were merged and the resulting single entity retained the name of one taxpayer, but used the Federal identification number of the second merged entity. The first audit covered January 1, 2000, through March 27, 2001, and the second covered March 28, 2001, through December 31, 2002. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments. Taxpayer protests these assessments, and requests refunds.

This Letter of Findings addresses issues raised by essentially two taxpayers. The predecessor company which paid Indiana income tax in the past and whose refund request was denied and the successor company which argues that it is not subject to Indiana income tax and that the audit's decision requiring it to file a combined return with eight related but out-of-state entities was erroneous. For simplicities sake, these two entities are referred to herein as "predecessor taxpayer" and "successor taxpayer."

I. Income Tax—Nexus.

DISCUSSION

Taxpayers protest that they did not have nexus with Indiana and so protest the assessments of income tax and also request refund of income tax previously reported and paid to Indiana. The Department conducted an investigation of the refund claims and denied the claims. Taxpayers again protest that they did not have nexus with Indiana, and so are not subject to gross income tax (GIT), adjusted gross income tax (AGIT), or supplemental net income tax (SNIT).

A. Gross Income Tax

The Indiana gross income tax was repealed in 2003, but for the years at issue was imposed under IC § 2.1-2-2(a), which stated:

> An income tax, known as the gross income tax, is imposed upon the receipt of:
>
> (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and
> (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

Also, 45 IAC 1.1-1-3 explained:

> (a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.
> (b) A taxpayer may establish a business situs in ways, including, but not limited to, the following:
> (1) Use, occupancy, or operation of an office, shop, construction site, store, warehouse, factory, agency route, or other place where the taxpayer's affairs are conducted.
> (2) Performance of services.
> (3) Maintenance of an inventory or stocks of goods for sale, distribution, or manufacture.
> (4) Sale or distribution of merchandise from company-owned vehicles where title to the goods passes at the time of sale or distribution.
> (5) Acceptance of orders without the right of approval or rejection in another state.
> (6) Ownership, leasing, rental, or other business activities connected with income-producing property (real or personal).
> (7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.
> (8) Other business or investment activities, other than de minimis, performed on behalf of the taxpayer by an employee of the taxpayer. These activities shall be considered together, not in isolation, in deciding if they are de minimis.

The Department's audit reports state that neither taxpayer had a physical Indiana location. The Indiana Tax Court has explained the applicability of gross income tax to nonresidents, and determined that there are three steps to reach such a decision. In *Enterprise Leasing Company of Chicago v. Indiana Department of State Revenue*, 779 N.E.2d 1284 (Ind. Tax Ct. 2002), the court explained:

> To determine whether gross income is derived from an Indiana "source," the Court must (1) isolate the transaction giving rise to the income ("the critical transaction"), (2) determine whether the Petitioners have a physical presence in, or significant business activities within the taxing state ("business situs"), and (3) determine whether the Indiana activities are related to the critical transaction and are more than minimal, not remote or incidental to the total transaction ("tax situs").
> *Id.* at 1290 (citations omitted).

In the instant case, and by the language of the Department's investigation report, neither the predecessor taxpayer nor the successor taxpayer met the requirements of 45 IAC 1.1-1-3 which would establish a "business situs" in Indiana. With no business situs in Indiana, neither taxpayer had a tax situs within Indiana, as explained by *Enterprise Leasing*, and therefore Indiana gross income tax is inapplicable.

B. Adjusted Gross Income Tax and Supplemental Net Income Tax

The adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant part:

> a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.
> In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter) only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance

> company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.
> ….

The SNIT was repealed in 2003. During the tax years at issue, IC § 6-3-8-5 stated that SNIT was to be treated in the same manner as adjusted gross income tax. Therefore, if a taxpayer had nexus for AGIT, that taxpayer had nexus for SNIT as well. If the taxpayer did not have nexus for AGIT, that taxpayer did not have nexus for SNIT.

45 IAC 3.1-1-38, in interpreting IC § 6-3-2-2(a), provides that for apportionment purposes a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including, but not limited to:

> (1) Maintenance of an office or other place of business in the state
> (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
> (3) Sale or distribution of merchandise to customers in the state directly from company owned or operated vehicles where title to the goods passes at the time of sale or distribution
> (4) Rendering services to customers in the state
> (5) Ownership, rental or operation of a business or of property (real or personal) in the state
> (6) Acceptance of orders in the state
> (7) *Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.*
> (*Emphasis added*.)

The Department conducted an investigation of both taxpayers' refund claims, and determined that both taxpayers did have nexus. Of relevance here is 15 U.S.C.S.381 (Public Law 86-272), which prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales.

The Indiana Supreme Court explained in *Indiana Department of Revenue v. Kimberly-Clark Corporation*, 416 N.E.2d 1264 (Ind. 1981):

> Public Law 86-272 (*15 U.S.C.A. § 381*), in pertinent part is as follows:
>
> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)
> *Id.*, at 1265.

The Court then explained:

> We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation."
> *Id.*, at 1268.

The United States Supreme Court explained its standard for determining “solicitation of sales” in *Wisconsin Department of Revenue v. William Wrigley, Jr.*, 505 U.S. 214 (1992). In *Wrigley*, the Court explained:

> We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly *essential* to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are *entirely ancillary* to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. n5 Cf. *National Tires, Inc. v. Lindley, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980)* (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to *increase* purchases; but it is not ancillary to *requesting purchases*, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, *e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967)* (no § 381 immunity for sales representatives' collection activities).
> *Id.*, at 228-30.

The Court further explained:

> By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee -- some company ombudsman, so to speak -- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases.
>
> Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are *de minimis*. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007[percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was *de minimis* in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.
> *Id.*, at 234-5.

Therefore, the Department may look at both predecessor taxpayer's and successor taxpayer's Indiana activities as a whole to determine if the activities as a whole provide nexus, respectively.

The Department conducted an investigation of the refund claim and addressed both taxpayers' claim of lack of nexus. The audit reports plainly state that both taxpayers have no physical Indiana location. The investigation listed the activities of both taxpayers' employees in Indiana as: a) Solicitation of orders through the use of a home office or visits to the customer's place of business, b) Distribution of displays, samples and/or other promotional materials, c) Submission of orders to [both taxpayer's] New Jersey headquarters for approval, d) Training, recruiting or evaluating sales employees, and e) Mediation of customer complaints. The court in *Wrigley* explained that these types of activities are ancillary to sales activities and so receive the same protection as direct sales activities. Therefore, the reasons referred to by the Department do not rise beyond mere solicitation, do not provide nexus for either taxpayer, and do not subject either taxpayer to Indiana GIT, AGIT, or SNIT for the tax years 2000 through 2002. Unlike Wrigley,

whose sales staff did in fact sell a small amount of gum to Wisconsin customer, which combined with the other Wisconsin activities to create nexus in Wisconsin, there is no indication that either taxpayer's sales staff in the instant case did anything to go beyond solicitation and solicitation-related activities.

C. Combined Return

As a secondary issue, both taxpayers protest the Department's decision to combine both taxpayers with related companies on income tax returns for the years at issue. Since it has been determined that neither taxpayer had nexus with Indiana for the years in question, the combined return question is now moot. None of the companies on the proposed combined return, including both taxpayers, had nexus with Indiana; therefore they are not required to file a combined return.

In conclusion, the taxpayers had no Indiana business situs and therefore no tax situs in Indiana. For gross income tax purposes, the income in question is not sourced to Indiana as explained by *Enterprise Leasing*. For adjusted gross income tax and supplemental income tax purposes, taxpayer's activities in Indiana did not rise above the protection of Public Law 86-272. The reasons cited in the Department's investigation are specifically rejected by *Wrigley* and *Kimberly-Clark*. Finally, there is no need to file a combined return, since none of the taxpayers had nexus with Indiana.

FINDING

Taxpayer's protests and refund claims are sustained.

WL/BK/DK July 23, 2007